

20 Questions Directors of Not-for-Profit Organizations Should Ask About Director's Duties

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Preface

The Not-for-Profit Governance Committee of Chartered Professional Accountants of Canada (CPA Canada) has developed this second edition of our guide to help directors of not-for-profit organizations (NFPs) understand and fulfill their director's duties.

Directors of not-for-profit organizations have various duties and responsibilities, the most fundamental of which are the fiduciary duty, or the duty of loyalty, and the duty of care. Successful fulfillment of these duties is critical both in terms of the wellbeing of the organization and in order to protect directors from liability. Not-for-profit organizations are very diverse and range from small all-volunteer groups to large, sophisticated enterprises. This publication will focus on the duties of directors of organizations in the corporate form, both those that are registered charities and those that are not. The law on directors' duties is complex, and this document is a general overview of the subject. Directors should seek expert advice on particular issues as they arise.

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Introduction

Directors of not-for-profit organizations have various duties and responsibilities. The most fundamental of these is the duty of care and the duty of loyalty, which is also known as the “fiduciary duty.”

Directors are sometimes referred to as the “directing mind” of the organization. Since the organization itself is in some sense an “artificial” construct, the law and the public look to the directors to ensure the organization remains accountable.

Where do directors’ duties and responsibilities come from? Some of them are codified in written laws in the form of statutes, while others are not. In Canada’s common-law provinces and territories, much of the applicable body of law on this subject is generated through court decisions. In Quebec, the rules are provided for in statutes, including the *Civil Code of Québec*. While the law varies to some degree across the country, the basic duties of directors are substantially the same. It helps that the Supreme Court of Canada, whose jurisdiction covers all of Canada, has provided guidance on this issue through landmark decisions.

It is important to note that some organizations may not refer to their fiduciaries as “directors.” In such cases, regardless of whether they are referred to as “directors” or another name (for example, the director-like officials may be called “trustees,” “governors,” “administrators,” “board members” or similar), the same basic duties and responsibilities apply to those individuals.

Throughout this publication, the term “not-for-profit organization” (NFP) or “organization” is used as an umbrella term to refer to all the different types of organizational structures available in Canada. This is only not the case where a section explicitly deals with a specific type of organization.

Specifically, not-for-profit organizations may be structured as non-share capital corporations, societies, co-operatives, unincorporated associations or trusts. An organization’s structure is different from its tax status under the *Income Tax Act* (Canada) as either a non-profit organization (NPO), another type of tax-exempt organization, or a registered charity. There are three types of registered charities: charitable organizations, public foundations, and private foundations.

The structure and type of organization with which one is involved has a direct impact on the duties of directors. The discussion that follows will focus on the duties of directors of NFPs that are corporations. While it will refer to some potential

For more information see
CPA Canada’s publication
[*Governance for Not-for-Profit Organizations: Questions to Ask*](#)

liabilities faced by directors, this is not the focus of this publication. The law on directors' duties is complex and this publication provides a general overview of the subject. Directors should seek legal advice on particular issues as they arise.

1. What is the role of a director of a not-for-profit organization?

A director is a person who participates in the administration, guidance, supervision, and approval of the affairs of an organization by being part of the governing, or decision-making body, of the organization – the board of directors. A director is one individual on the board of directors. Note again that the title may not be “director”; it may be governor, trustee, administrator, board member, or a different title.

In a small organization, the board may be hands-on, with a director wearing multiple hats. In addition to their role as director (overseeing the activities of the organization), they may also have separate roles as an officer (responsible for the day-to-day operation of the organization) and perhaps as a member of the organization. As an organization reaches maturity, the board becomes a governance board, with the director and officer roles fulfilled by different individuals.

Directors have an overall responsibility for the organization and oversee the strategy for achieving the organization's legal purpose. Directors are required by statute and the common law to understand:

- why the organization exists
- how it is legally structured
- what interests its stakeholders (the individuals and other beneficiaries the organization is established to serve)
- what its financial situation is
- how it manages the risks it faces

Directors should also be involved in the approval and, at times, the development of the strategic plan.

Each province and territory in Canada has its own statute that sets out the rules that both the not-for-profit organization and its directors must follow. The same is true for federal not-for-profit organizations. Similarly, each jurisdiction also has its own “standard” against which directors are judged by a court if the organization is involved in a lawsuit.

For more information see CPA Canada's publication [*Governance for Not-for-Profit Organizations: Questions to Ask*](#)

For more information, see [Question 9.](#)

2. Are there different kinds of directors?

A “true” director of a not-for-profit organization is an individual who is elected or appointed to sit on the board of directors of the organization and who has full voting privileges as a director. Individuals who sit on an advisory board, or who are *ex officio* non-voting or honorary directors, are generally in a different legal position than “true” directors. Some examples include:

Ex officio directors

Ex officio directors are individuals who qualify as directors by virtue of an office they hold, rather than being chosen through a selection process. The by-laws usually say that they are entitled to be directors by reason of holding some other office. An example of a by-law provision providing for an *ex officio* director is:

The President of ABC Corporation shall be a director of ABC Non-Profit.

Certain statutes, such as the *Canada Not-for-profit Corporations Act*, do not permit *ex officio* directors; however, all or a portion of the directors on the board can be required to possess certain qualifications in order to be eligible to serve as directors. For example, the by-laws could provide in the director qualification section that at least one director on the board must have previous involvement with the organization as an officer of the organization.

Honorary directors

The term “honorary director” is sometimes used to refer to an individual who is given the title as appreciation for their service and does not have voting rights. An advisory board consists of individuals (often past directors) not actively involved with the organization but who provide advice as needed.

A non-voting individual is generally permitted to attend but not vote at board meetings and may or may not be entitled to attend in-camera meetings of the board (generally speaking, in-camera meetings are confidential meetings of the board held without the presence of management or directors who are in a conflict of interest). To avoid confusion and potential legal claims, it is best not to use the word “director” when referring to individuals who are advising the board or who are not intended to be “true” directors.

While those who do not have voting privileges do not have the same duties and responsibilities as a voting director, if an individual who is not a true director acts like a director, making decisions along with the rest of the board, there is a risk that a court could subject them to the same fiduciary duty and other obligations as a director, including liabilities.

If the limitations on the role, duties, and rights of non-voting individuals are not clearly set out in the by-laws of the organization, such individuals may be mistaken for true directors. This puts them at risk that the courts will treat them as directors if the organization faces any claims, grievances, or court actions.

Example

Jasmine has spent many years volunteering on behalf of Small Town Figure Skating Club and has acquired a tremendous amount of knowledge about the organization. Jasmine does not want to be a director of the organization, so in appreciation for her many years of hard work, the organization suggests that Jasmine assume the role of honorary director. She attends board meetings and provides her views; however, Jasmine is not entitled to vote on any matters discussed by the board.

Issue: During a practice, Pierre and Manon, a promising ice-skating pair who train with the organization, collide with the rink boards. Manon suffers a broken arm and Pierre breaks his leg. Neither will be able to compete this season, and as a result may not be spotted by the national coach looking for new protégés. Due to the size of the organization, the directors oversee the day-to-day management of the organization’s few employees through the human resources committee of the board.

A few weeks before the accident, the directors approved the committee’s recommendation to dismiss the employee responsible for overseeing the safety of the facility. The board resolved to post a job ad to fill the vacant position as soon as possible, but in the meantime did not make alternative arrangements. Jasmine was at the meeting where the board approved the recommendation, and she took part in the discussions. When the chair of the meeting asked for a show of hands of those in favour of the resolution, Jasmine raised her hand.

Problem: If the by-laws of the organization do not clearly set out the rights and restrictions of an honorary director, there could be confusion about Jasmine’s role, and even though neither she nor the organization intended for her to be a director, it may appear to others that she is a true director. If the organization and its directors are sued as a result of the accident, Jasmine’s actions may be taken into account when the court is assessing potential wrongdoing on the part of the organization. In the lawsuit, she may also be liable as a director.

3. What is a “fiduciary”?

A fiduciary is a person who has a legal duty to act for another person’s benefit. The law imposes duties on those in a fiduciary relationship to protect those who are vulnerable from those who have power over them. Fiduciaries must put the interests of the other person above their own.

Directors are in a fiduciary relationship because of the position they occupy within the organization. The assets belong to the organization and are even “public” assets in some circumstances and can only be managed through its directors.

For more information, see [Question 12](#).

Another example of a fiduciary relationship is a trust relationship. The trust property is held and owned by trustees who have complete control over it, and the beneficiary is for all intents and purposes at the mercy of the trustees. The law imposes an obligation on the trustees to safeguard the rights of the beneficiary.

Being a fiduciary means that directors will be held to high standards of good faith, fair dealing, and loyalty regarding the organization. The specific duties are similar across corporate sectors (for-profit and not-for-profit) and have been imposed by statute in some Canadian jurisdictions.

4. What is the duty of loyalty?¹

The duty of loyalty is also known as the “fiduciary duty,” and it requires that a director act honestly and in good faith in the best interests of the organization. It is one of the primary duties of directors. It is a personal duty and cannot be delegated.

For more information, see [Question 17](#).

The duty of loyalty also means, among other things, that a director is not allowed to profit from their office and must avoid all situations in which their duty to the organization conflicts, or appears to conflict, with their interests or duties to others (the “no-conflict” rule). Unless sanctioned by the board, directors must not share the organization’s confidential business outside board meetings. They must treat in-camera meetings as strictly confidential. The board chair should keep any minutes of in-camera meetings separate from the organization’s minute book.

For more information, see [Question 5](#).

Directors retain many of these duties even after they resign or retire. For example, it is a breach of the duty of loyalty to compete with an organization for a lucrative contract which a director became aware of while on its board. Similarly, former directors should not disclose or in any way use confidential information they learned about while they were in office, nor should they disclose or use information that was the subject of board or committee meetings generally.

1 Adapted from the now archived publication *Primer for Directors of Not-for-Profit Corporations*, published by Innovation, Science and Economic Development Canada, 2002.

5. How can a director fulfill the duty of loyalty?²

Most questions about how to fulfill the duty of loyalty arise in the context of a conflict of interest. A conflict of interest can develop in two general ways:

1. A personal conflict between the director's self-interest and their duty to act in the organization's best interest. For example:
 - A director stands to gain financially, or some other material or intangible way, from a proposed contract or transaction between the director (or their corporation or firm) and the organization.
 - A director has a child, relative, friend, business partner or contact who may benefit from the organization.
2. A conflict between the duties the director owes to the organization they serve and those they owe to another organization. For example:
 - A director serves on the board of two organizations - and owes the same duty of loyalty to each - and the organizations are involved in a transaction.

Example

A charity's mandate is to work with underprivileged children. One of its projects is to sponsor underprivileged kids for summer camps by awarding scholarships to those who meet certain criteria the board has developed. Gisele, a board director, has a brother who has fallen on hard times and cannot afford to send his daughter to music camp this summer. Gisele's niece is a very talented pianist, and the summer camp experience would help her improve her playing to the point where she might win a university scholarship to study music.

Issue: Gisele is in a conflict position because she has a fiduciary duty to the charity. Even though she would prefer to recommend her niece for a scholarship, Gisele is required by law to do what is in the best interests of the charity, rather than what is in the best interests of her niece. Gisele could recommend to her niece that she apply. However, the law and the organization's policies would require that she declare her conflict to the board and recuse herself from adjudicating her niece's application or being in any related discussions. For Gisele's niece to be considered for a scholarship without the organization risking being off-side of its legal obligations - and Gisele of her fiduciary duty - the organization must have clear, objective criteria in place to determine applicants' financial need. It is possible that Gisele's niece could qualify by meeting the objective criteria alone, as determined by the other directors or those qualified to judge [applications](#).

The courts are very strict about the no-conflict rule as it relates to personal conflicts. A director must avoid not only actual conflict, but also the appearance of conflict.

Fulfilling the duty seems simple enough. Directors must:

1. act with a view to the best interests of the organization and not their own interests
2. avoid situations in which they have competing fiduciary duties.

² See Footnote 1.

But not all situations in which directors find themselves are clear cut: Many organizations have directors who are in a conflict of interest from the moment they are elected or appointed as a result of an inherent conflict (such as being a beneficiary of the organization's programs). Some of these conflicts of interest are unavoidable, for example, where a specific board composition is considered desirable and especially where the perspective of certain types of directors is important to running the organization's programs.

In such cases, the intent is not to eliminate the real or perceived conflicts of interest, but rather to manage them appropriately by ensuring conflicts are declared and recorded and that board members in a conflict-of-interest position recuse themselves from decision-making.

For example, it is easy to see why it may be desirable for the board of a golf club to include directors who are members of the club, or for the directors of a school to include parents of the school's students. That said, it is important to remember that a director has ongoing fiduciary obligations to the organization they serve, even outside of board meetings and committee meetings.

To help avoid conflict-of-interest situations or deal with conflicts as they arise, you may find the following tips useful:

- Remind yourself of the reason you wanted to join the organization as a director.
- Ask yourself who you want to benefit: Is it the organization and the individuals it was established to serve? Or is it yourself, a family member, friend or business connection?
- If you, or a person related to you, are going to benefit in some way (either directly or indirectly, materially or intangibly), then you will likely be in a conflict situation. Whether you are indeed in a conflict will depend on the facts of the particular situation. That said, you must disclose all real or potential conflicts so that they can be dealt with appropriately.
- If the organization has a conflict-of-interest policy, review it on a regular basis, understand it, and apply it to the situations you face as they come up.

If the organization is a charity where you also receive a direct or indirect benefit, they may need to seek court approval or pass resolutions confirming that they considered certain specific factors before allowing you to sit on the board. The procedure that needs to be followed for a director to continue to benefit depends on the jurisdiction in which the organization is established. In most instances, regardless of a particular jurisdiction's rules, charities should proceed with great care when considering whether a director should benefit. It is important for boards to document potential conflicts, and their discussions and decisions on how they are addressed.

For more information, see [Question 14](#).

For reputational reasons, or to maintain the charity's registration under the *Income Tax Act*, it may not be possible or in the best interests of the organization for directors to benefit in any way.

Representative directors

A representative director is someone who holds the role by virtue of being a named representative (such as the president) of another organization.³ This creates unique challenges.

Example

A director sits both on the board of a chapter of a national non-profit and on its national board of directors. The board of the chapter considers that the director sits on the national board in a "representative" capacity. In other words, the chapter's board expects that the director will further the chapter's agenda. At law, the director owes fiduciary duties to both the national organization and the chapter organization when carrying out their director responsibilities with each.

The director must declare any potential conflicts involving the two organizations. In such cases where the chapter's best interests are not aligned with those of the national organization, or vice versa, the director may be in an untenable situation. The organizations could be prejudiced and the director may have triggered personal liability by failing to discharge their fiduciary duty.

If you sit as a director of two "related" boards in an association or national structure, consider the following tips:

- Apply each organization's conflict of interest policy to conflicts as they arise, which will likely involve regularly declaring conflicts and abstaining from both discussion and voting on various issues during meetings.
- If being on two boards in an organization creates continuing conflicts of interest both inside and outside the boardroom, consider speaking to the chair of each board to voice your concerns; if they cannot or do not address your concerns to your satisfaction, consider resigning from one or both boards.
- Where there is significant overlap between two related boards resulting in more than one director with a conflict of interest, consider whether either or both organizations should review their by-laws as it may be time to change the composition of the boards.
- Consider the reasons why there may be conflicts between the two organizations. It is in the best interests of the organizations to address any underlying sources of conflict in a productive way.

³ Having a person sit as a "representative director" is different from a structure where a local chapter is itself a member of a national non-profit. Under this structure, the local chapter appoints an individual representative who receives instructions from the board of directors of the local chapter to vote, as a member of the national non-profit, in a manner that benefits the local chapter at its (i.e., the member's) discretion.

6. What should a director do if faced with a conflict of interest?

Before joining the board of an NFP, prospective directors should consider whether their personal interests or fiduciary duty to another organization might lead to a conflict of interest that would prevent them from fulfilling their duty to the not-for-profit organization and, thus, from joining the board. Once on the board, where possible, directors should avoid conflicts of interest. However, should a conflict of interest arise:

- Where the conflict arises at a board meeting, a director should immediately declare the conflict and abstain from voting (and, if necessary, recuse themselves from the meeting).
- Where the conflict, or potential conflict, arises outside of a board meeting, the director should take the following steps as soon as possible:
 - Review the organization’s conflict of interest policy to determine whether there are specific requirements or an identified process that they must follow for declaring a conflict and, if so, who the designated person is that they should report the conflict to.
 - Consider the organization’s governing legislation to determine if it addresses the declaration of a conflict of interest.
 - Speak to the designated person identified in the conflict-of-interest policy (or, failing that, the chair or vice-chair) about the nature of the conflict, particularly where the director is unsure if a conflict truly exists.
- Where the conflict places the director in a situation in which they believe they cannot act in the organization’s best interest, they should resign.

Most not-for-profit corporate legislation in Canada provides for a narrow exception to the no-conflicts rule where a director has an interest in a contract or proposed contract with the organization, declares the conflict and follows the process outlined in the legislation.⁴

This kind of statutory exception is not generally available to directors of registered charities, depending on the province in which the charity operates. Because of the premise that charities are there for the public good, directors of charities must avoid any interest in a contract unless they receive court approval ahead of time or specific resolutions are passed.

It is important to note that legislation typically only refers to “material” contracts and transactions and does not cover all conflicts.

4 For example, section 141 of the *Canada Not-for-profit Corporations Act* states that it is the duty of a director to declare an interest in a proposed or existing material contract or transaction with the organization. The section contains specific requirements relating to the timing and content of their declaration of interest. With limited exceptions, it prohibits directors from voting on the existing or proposed contract in which the director is interested. The Act specifically provides that a director who has complied with the declaration of interest provisions is not accountable to the organization or its members for any profit realized by such contract and the director will escape any liability where the members of the corporation have confirmed that they are aware that the director stands to make a profit.

7. What is the duty of care?⁵

The duty of care is a duty to exercise care, diligence and skill. This means that a director must generally be informed about an issue before making a decision relating to that issue. The law does not require directors to be experts but rather to act in accordance with a particular standard of care.

For more information, see [Question 9](#) and [Question 10](#).

It is generally accepted that the duty of care is heightened for directors of a charitable organization. Generally speaking, this means that directors on the board of a charity must take additional care and attention when discharging their duty of care.

For more information on the duty of care specific to directors of charities see [Question 11](#).

8. How can a director fulfill the duty of care?

The duty of care requires that directors pay attention and try to make good decisions for the organization. This duty comprises the following responsibilities:

The duty to act honestly

- Directors must deal honestly with the organization and not act for an improper purpose.
- Directors should be candid about informing the chair if they can no longer afford the time commitment of being a director.

The duty of diligence

- Directors must be diligent in attending to their legal duties. They do so by being familiar with the organization, being informed, and preparing for and attending meetings.
- Where advice of a specialized nature is required, the board should engage qualified professionals.
- Directors should exercise their best judgment when voting on any decisions, and not simply vote with the majority without being informed or having formed a view on the particular issue.
- Directors must properly maintain minutes of meetings and ensure that all other corporate books and records of the organization are being maintained accurately and in proper order.

⁵ See Footnote 4.

The duty to exercise power

- Directors are ultimately responsible for the organization and thus must make decisions. Because they are responsible for furthering the organization’s goals and objectives, they can breach their duty through inaction and inattention.
- Directors should develop standards for measuring senior management performance and carry out annual performance [reviews](#).
- In the case of a charity, funds received from the public for a specific charitable purpose must be held in trust for the charitable purpose and directors have an obligation to apply the funds in keeping with the charitable purpose for which the public understood they would be used.

The duty of obedience

- Directors must comply with all applicable laws and the organization’s governing documents (letters patent or articles, by-laws, etc.)
- Directors must ensure that corporate decisions are being implemented.

9. What does it mean to have a “standard of care”?

Directors must carry out their obligations with an appropriate degree of skill and care and in accordance with the relevant “standard of care.” The standard of care may be an objective or subjective standard – it varies across the country. In some provinces and territories, the incorporating statute is silent as to the relevant standard, thus the common-law subjective standard applies.⁶ In others, the statutes explicitly provide for an objective standard.⁷

What is the difference between a subjective and objective standard of care?

The objective standard judges all directors against the same criteria. Directors are required to exercise the degree of care and skill of a “reasonably prudent person.”

The subjective standard judges directors against their own personal characteristics, attributes, skill level, education, experience and profession. Each director must exercise the degree of care and skill that one may reasonably expect of a person with their particular knowledge and experience. The more sophisticated the director, the greater the care they must exercise. As a result, if a director is a professional such as a lawyer or accountant,

⁶ This is the case in Alberta, New Brunswick, Nova Scotia, Nunavut, Prince Edward Island, Quebec and the Yukon.

⁷ This is the case in British Columbia, Manitoba, Newfoundland, Ontario, Saskatchewan, and federally under the *Canada Not-for-profit Corporations Act*.

the law expects them to apply that expertise in their director role, and they will be held to a higher standard. Likewise, a director with sophistication in running a business or other organization – whether or not they also hold a professional designation – will also be held to a higher standard.

It is recommended that prospective directors be familiar with the standard of care that applies to them in carrying out their duties. If an organization or a director is sued, the court will consider whether the director acted in accordance with the appropriate standard.

10. How knowledgeable do directors have to be in order to discharge their duties?

The law does not require directors to be experts. While directors of not-for-profit organizations owe a duty of care, it is not realistic to expect directors to understand in detail all of the operations, laws and government policies affecting the organization. However, directors *should* be well-informed.

Examples

The organization has paid staff – Directors should know that there are laws affecting the organization and its relationship with employees related to employment, human rights, income tax, Canada Pension Plan and unemployment insurance. They should know when to seek legal advice.

The organization is an incorporated charity – Directors should be aware of and seek legal advice about legislation that applies to the organization, including laws governing:

- income tax
- corporations
- trusts
- provincial charities
- fundraising registration and licensing
- municipal, provincial, and federal lobbyist legislation
- privacy
- anti-spam

The organization owns heritage property – Directors will need to understand what they are permitted to do with the property and within the province or territory (and usually within the city or town) in which the property is located.

The courts recognize that directors must be guided by what is referred to as the “business judgment rule.” They look to see that the directors made a *reasonable* decision, not a *perfect* one. In coming to a decision, directors must show that they acted prudently and on a reasonably informed basis.⁸

⁸ *Peoples Department Stores Inc. (Trustee of) v. Wise*, 2004 SCC 68.

As a result, directors should:

- have a general knowledge of what laws affect that type of organization
- inform themselves about the governance model and structure of the organization, what the organization does, how it does it and who its beneficiaries are

The following guidelines have been established by the courts:

- Directors are not liable for mere errors of judgment.
- Directors are not required to give continuous attention to the organization's affairs.
- The directors' responsibilities are intermittent and performed at periodic board and committee meetings.
- Directors need not attend all board meetings.⁹
- Directors may entrust certain matters of business to officers of the organization.
- Where there are no grounds for suspicion, directors are justified in trusting that officers of the organization will perform their duties honestly.¹⁰

11. Are directors of charities held to a higher standard of care?¹¹

Where a not-for-profit organization is also charitable (either a registered charity or charitable according to common law),¹² directors may be required to meet additional expectations – and a higher standard of care. This is especially true when the organization carries on all or some of its activities in Ontario.¹³ That province's legislation specifically characterizes the legal nature of a charitable organization as that of a trustee, and Ontario case law has determined that directors of charities “are, to all intents and purposes, bound by the rules which affect trustees.”¹⁴

9 While attendance at all board meetings is not required, there should be a clear expectation of 100% attendance at board and committee meetings, barring extenuating circumstances.

10 *Re City Equitable Fire Insurance Company Limited*, [1925] Ch 407.

11 See Footnote 1.

12 It is important to note that some organizations may have purposes that make them charitable pursuant to case law, but they are not registered charities under the *Income Tax Act* (Canada). This situation should be avoided. Directors should review the purposes of the organization, and if they are charitable, the organization should apply to the Canada Revenue Agency for registration as a charity. Otherwise, the purposes should be amended to ensure that the letters patent or articles of the organization meet the requirements of the desired type of organization.

13 *Charities Accounting Act*, RSO 1990, c C.10, subsection 1(2).

14 *Ontario (Public Guardian & Trustee) v. AIDS Society for Children (Ontario)*, [2001] O.J. No. 2170, 39 E.T.R. (2d) 96.

This means that they must take proactive steps to protect charitable property. Any loss of charitable assets due to the directors' inactivity or failure to act could result in liability where the director has to pay damages to the organization, or even in criminal liability.

While the law is not uniform or even settled on this point across the country, it is prudent for directors of charities to carry out their duties as though they have charge of property that is subject to a trust. This "trustee standard" is generally considered to be more demanding in law, and it goes beyond what is ordinarily expected of either a not-for-profit or a for-profit director. This standard requires directors to exercise the degree of skill and prudence comparable to how a reasonable and prudent person would manage their own affairs. Under this standard, directors of charities must maintain the trust property and are responsible for making prudent investment decisions, subject to any requirements of provincial trust statutes.

From a practical perspective, this means that directors of charities should pay close attention to risk issues affecting the organization, especially as they pertain to the organization's finances. Organizations should develop a risk register capturing the risks to the organization's operations, assessment of the impact and likelihood of the risk, and mitigation strategies put in place by management. Boards should review the risk register at least once a year to gain assurance that [organizational](#) risks have been identified and are well mitigated. In addition, directors should require regular financial reporting, especially as it relates to donations received and terms or conditions attached to grants and donations (special purpose or restricted gifts). This financial reporting should also ensure that the organization properly applies donations, endowments and investments of its funds. Directors of charities should ensure that the organization develops and maintains an investment policy that observes applicable legal requirements around investments.

For more information see [Question 15](#).

12. To whom are these duties owed?

In a not-for-profit organization (NPO), the board of directors owes these duties to the organization itself. Although the members of the organization elect the directors and usually have the ability under the by-laws to remove the directors, the directors generally do not owe the members these duties.¹⁵ In situations where the interests of the members are at odds with those of the organization, in most circumstances the directors' duty is to the organization, not to the members (as opposed to the for-profit context where the duty is to the shareholders).

¹⁵ Directors may have other, non-fiduciary obligations towards members pursuant to the legal rules and documents that govern the organization.

There is a narrow exception for certain NPOs. NPOs can generally be divided into two categories: mutual benefit and public benefit.

- Mutual benefit NPOs are accountable to their members in a direct way – their purpose is tied to benefitting members.
- In public benefit NPOs, the members are more like supporters than they are like beneficiaries of the NPO's activities – in these cases, the directors need to demonstrate accountability to the NPO's "public" rather than to its members.

The directors of registered charities are considered to have "trustee-like" attributes, and they are subject to a duty to act as quasi-trustees of the organization's charitable property. Their duty is owed to the charitable purposes of the organization, the charity itself and – some would argue – even to the charity's donors. Directors of charities must act with extra diligence and care when carrying out their duties.

13. Can the directors permit the organization to act outside the scope of its objects?

A not-for-profit organization is allowed to carry on those activities that fit within its objects, which are described in its letters patent or articles. Objects are essentially corporate "purposes" – they set out the general reasons for which the organization was established. Directors have an obligation to know and comply with the organization's objects and should ensure that its activities and programs are permitted by its objects. If directors cause the organization to act outside of these objects, these actions are void, and directors may be personally liable for any resulting losses.

The directors of registered charities must also ensure that the charity's programs and activities qualify as charitable under the law. Carrying on programs and activities that do not qualify as charitable is grounds for revocation of a charity's status under the *Income Tax Act* (Canada).

Organizations also have statutory powers set out in the legislation that applies to them. These statutory powers generally permit the directors to take certain actions on behalf of the organization that are not specifically contemplated in the organization's objects or potentially elsewhere in their governing documents (i.e., in their articles, letters patent, constitution or by-laws). These actions include borrowing money, and buying and selling property. These statutes may also contemplate that organizations have the rights, powers and privileges of a "natural person." This essentially means that the organization has the same rights, powers and privileges as a real individual. The organization can enter into contracts, sue or be sued and be convicted of a crime.

Example

The letters patent of a not-for-profit corporation state that the corporation's object is to relieve poverty by gathering and distributing used clothing to the homeless. The corporation applies for and receives charitable status.

A few months later, the COVID-19 pandemic hits. The directors realize that what is really needed is equipment and supplies to help protect homeless people from contracting the virus. As fiduciaries, the directors must understand on what basis this new activity qualifies as charitable. The corporation should amend its objects if it plans to carry on this activity permanently.

14. Can directors of charities receive remuneration or other benefits?

This question is a common one, and it is not easily answered.

Depending on the province in which the organization operates and whether the organization is a charity, the duty of loyalty and the no-conflict rule may prohibit directors from receiving any direct or indirect benefit from the organization.

The issue can come up for directors of charities in different ways. Here are some example scenarios:

- The founder of a charity is also a director and, as the charity grows, the founder becomes a paid executive director.
- An organization's by-laws provide for a beneficiary of the organization (a person receiving benefits or services from the organization) to sit as a director.
- An organization develops a practice over time that the chief staff person will be on the board of directors.

Leaving aside any conflict issues that these arrangements could involve, the question of whether the director can receive any benefit will depend on the province in which the organization operates. The general rule of thumb is that directors of charities are prohibited from receiving remuneration or other benefits, whether directly or indirectly, in their capacity as directors. While tax¹⁶ and corporate statutes¹⁷ do not generally prohibit directors of charities from being paid, the common law and in some cases provincial trust laws may prohibit payment to a director without a court order.

16 The guideline used by the Canada Revenue Agency is "reasonableness."

17 Some non-profit corporate statutes (i.e., Ontario and Saskatchewan) specifically allow directors to receive reasonable remuneration. But directors of charities are also subject to the common law and provincial trust laws.

In limited circumstances, directors of charities may also be employees of the charity or paid by the charity for services they provide. In some cases, this may require a court order. In other cases, the directors must pass resolutions that confirm that they considered certain factors before approving the payment. It is recommended that you seek legal advice if your charity is considering remunerating a director.

There is generally no such prohibition on directors of not-for-profit organizations that are considered NPOs (i.e., not registered charities) under the *Income Tax Act* (Canada). These directors can usually receive remuneration or other benefits from the organizations they serve. To complicate matters further, a non-profit may be considered charitable at common law but not be registered federally as a charity under the *Income Tax Act* (Canada); as such, they would be prohibited from remunerating directors.

Remember that there is a difference between being paid by the organization and being reimbursed for legitimate out-of-pocket expenses incurred while performing a director's duties. Directors are almost always entitled to be reimbursed for reasonable out-of-pocket expenses subject to any provision to the contrary in the by-laws or operating policies of the organization.

Example

André is a director of a charitable organization established to relieve poverty in Africa by providing food, housing and marketable skills to those in need. The organization is incorporated in Ontario and has its head office address in Ontario. André spends most of his time in Africa working with the local population to carry out the charity's mission. André considers his work on behalf of the charity as his "job." He has an expense account which covers his travel, accommodation, food and clothing.

In Ontario, it would generally be acceptable for the organization to pay for André's travel, accommodation and food for certain types of trips that he needed to take in his capacity as a director. In most cases, it would not be reasonable for an organization to pay for a director's clothing or for unreasonable or unnecessary travel, accommodation and food expenses. The organization should seriously consider whether all the expenses related to André's work are in fact necessary (for example, perhaps some of the work can be carried on from head office via video-conference or other electronic means) and only pay for those expenses that are truly reasonable and necessary.

Since André spends most of his time in Africa working directly on the charity's programs, the organization needs to consider whether the work André is doing on behalf of the organization is in the nature of work carried on by an employee or a service provider. It would be advisable in this circumstance for the organization to also consider:

- whether it needs to obtain court approval in order for André to remain a director while being paid by the charity, or
- whether, before doing so, the directors can pass resolutions confirming that the payments are appropriate and that they have considered the factors required by Ontario legislation and policy.

In other jurisdictions in Canada, André may be able to receive a reasonable compensation by the charity without having to go to court or pass specific resolutions.

Seek professional legal advice before paying directors of charities.

15. What duties do directors of charities have when it comes to gifts?

Fundraising is important to most charities. Whether the fundraiser is a walkathon, a readathon, a door-to-door canvas, crowdfunding, a public campaign, an event, or a gift through an estate, directors of charities must pay attention to:

- how a charity raises funds¹⁸
- for what purpose donors understand that the money is being raised
- how the money is ultimately used
- how it is accounted for and reported to the Canada Revenue Agency¹⁹
- how the organization provides receipts²⁰

In addition, directors of charities have a legal duty to apply special-purpose or restricted gifts towards the purpose specified by the donor. If they fail to do so, directors may face personal liability. The heightened duty of care for directors of charities, discussed in [Question 11](#), applies to directors who manage property that is subject to a trust.

Examples

Consider these two scenarios:

- A charity completes a fundraising drive to raise funds for a particular educational conference. The fundraising material tells prospective donors that their gifts will be used to hold the conference.
- June Bukowski leaves \$10,000.00 in her Will to the Anytown School. She leaves instructions that the money should be used for the charity's reading program offered specifically to special needs children.

Depending on the specific circumstances of these donations, what is called a "special-purpose charitable trust" *may* be created, and the money the charity receives must be used for the specific charitable purpose. Note that the terms attached to the charitable trust may be created by the charity or by the donor. Directors may be found in breach of trust if they do not comply with the terms of a special purpose charitable trust, meaning that they could be found personally liable if they do not comply with the trust's terms.

18 Alberta and Saskatchewan have fundraising registration requirements for charities or fundraising companies working for charities.

19 The Canada Revenue Agency sets out its policy on fundraising by registered charities in guidance number CG-013 "Fundraising by registered charities," issued on April 20, 2012.

20 The *Income Tax Act* (Canada) and the Canada Revenue Agency have strict rules on the receipting of gifts by registered charities.

Directors should:

- be aware of and comply with the terms of any special purpose trust funds
- oversee the organization's fundraising program so that they are aware of staff or professional fundraisers' methods that may lead to a special-purpose trust fund being created
- ensure the organization has an internal means of tracking ongoing compliance with the terms of any special-purpose trusts
- apply for a court order to vary the terms of the trust if the charity is no longer capable of fulfilling the terms of any special-purpose trust

16. What if a director breaches their duties?²¹

Directors who breach their duties are at risk of being found personally liable if the organization suffers a loss which can be attributed to the directors' actions or omissions.

For an individual director to be held liable (and to pay damages), the breach has to result in a loss which can be traced back to them. In the case of a charitable organization, the loss could be to charitable property comprising a special-purpose charitable trust. For example, directors could be held personally liable for breach of trust if they mismanage the charity's assets - meaning that they can be personally responsible for the full amount of any loss to the charitable assets.

In each case, liability will depend upon the particular facts and circumstances at play, thus obtaining legal advice is critical.

It should be noted that the organization's indemnification provisions in its by-laws or its policy on indemnification may not be available to directors who have breached their duties; similarly, insurance coverage may not be available.

²¹ See Footnote 1.

17. Can directors delegate their authority and/or their responsibility?²²

Directors are entitled to delegate some of their responsibilities to committees, officers, staff or **even members** of the organization. However, even though they may have delegated a certain task, they are still responsible for it. They must be legally entitled to delegate the particular responsibility, and they must continue to monitor performance.

A director cannot delegate all of their director's responsibilities to another person. The reason: Wholesale delegation would usurp the roles of the organization's directors, which contemplate that each have separate duties and responsibilities.

If intending to delegate core responsibilities, it is wise to set out such delegation in the by-laws or policies of the organization that the directors have approved by resolution. These documents should include:

- the scope and duration of the delegation
- the requirements for reporting back to the full board
- the relationship between the board and the body or individual the matter is being delegated to

Further, such delegation should ideally only be made to a board committee or individual authorized by the by-laws or board-approved policy.

Where directors of charities may be considered trustees, their ability to delegate decisions about the treatment of charitable property may be even more constrained. At common law, trustees are generally not allowed to delegate these types of decisions. However, directors should consult provincial legislation governing trustees to determine if it permits some delegation by trustees.

The following are examples of both permitted and non-permitted delegation:

Example 1: Permitted delegation

The directors hire an executive director. The executive director runs the organization's day-to-day activities and reports to the board of directors at each board meeting. Day-to-day activities the board may delegate include hiring and supervising the office staff and volunteers, running programs, arranging board meetings, implementing the budget approved by the board, etc.

Example 2: Non-permitted delegation

The directors hire an executive director and delegate all responsibilities of the organization to that role. The executive director sells significant assets of the organization. This is a matter that may not be delegated by the directors.

²² See Footnote 1.

18. What if a director disagrees with a decision the rest of the board has made?

Whether by majority, two-thirds or some other level of decision-making, a decision made by the board of directors, means that the board has spoken on behalf of the organization. Every director is responsible for the decision, whether or not they were at the meeting. This also means that every director is jointly and severally liable along with the other directors if a loss occurs as a result of their decision.

If a director disagrees with a decision, silence is never a prudent course. It is important for a director who disagrees with a decision made by the board to voice their objection at the meeting and to ensure that their dissent is recorded in the meeting minutes, preferably with reasons. Then, at the start of the next board meeting, they should follow up to ensure that the minutes properly record their dissent.

Depending on the circumstances, a properly recorded dissent may result in the director limiting their personal liability. In addition to fulfilling their duty of diligence, being present for all board meetings (barring extenuating circumstances) can be helpful in limiting a director's liability in certain instances as long as the board takes appropriate steps when the director disagrees with the rest of the board.

If you are a director who cannot attend a meeting, obtain copies of the minutes and any materials considered at the meeting. Read the minutes and be sure to immediately state any objection you may have in the form of a written dissent to the secretary or chair of the board.

If you are concerned about liability, seek independent legal advice.

19. When should a director seek independent legal advice?

When a director retains and pays a lawyer to provide advice, they are seeking independent legal advice - that is, independent from the organization and the board.

Disputes and disagreements among directors can arise. A director may disagree with the direction the organization is going in and may be a minority voice on the board. At other times, the board may not function effectively, and a director may feel that they cannot fulfill their duties for a variety of reasons. To limit liability, it may be sufficient to require

that the organization record the director's dissent in the minutes of a board meeting; but there are times when a director may need specific legal direction – usually to minimize their exposure to liability.

There are any number of instances in which it may be advisable to get independent legal advice, several of which are discussed earlier. As a general rule, if you are a director who feels you cannot properly discharge your obligations to the organization for any reason, or if you consider that you may have personal liability, seek independent legal advice.

The following examples may help you determine when a director of a not-for-profit organization should consider obtaining independent legal advice:

- A director believes that a particular program may not be permitted by the organization's objects, and the board has decided not to seek related legal advice.
- A director is concerned about a certain issue or matter involving the organization and does not feel that their concerns have been properly addressed.
- A director believes that the board may be found negligent as a result of a particular decision or omission.
- A director considers that another director has an insurmountable conflict of interest regarding a certain matter, which is being ignored by the board as a whole.
- A director is unable to obtain certain financial or other information about the organization from its board and staff, and as a result they are concerned about meeting their obligations.
- A director is concerned about their personal liability regarding an ongoing program and requires advice on the effects of their resignation.
- The organization is insolvent, and the director wishes to determine if they will have liability for debts of the organization, especially those involving employees and taxes.

20. What tools can directors use to assist them in discharging their duties?

Directors have many tools available to them to discharge their duties. The following are helpful, particularly to new directors:

- board manuals including the following items:
 - the letters patent and supplementary letters patent of the organization, or articles of incorporation / continuance and articles of amendment
 - current by-laws of the organization

- code of conduct for directors
- financial information
- charitable registration information
- minutes of recent meetings
- insurance policies
- board policies (which may also be included in board manuals) such as:
 - conflict of interest
 - risk management
 - fundraising, gift acceptance, endowments and donor advised funds
 - human resources
 - investment
 - privacy / cybersecurity
 - anti-spam

Educational sessions on subjects such as corporate governance and risk management can be very enriching and informative for boards. As well, board retreats allow directors, and often the senior staff, to get together for an extended period to review the vision, mission and/or strategic plan of the organization without outside distractions.

Professional assistance is a key tool that boards should use in discharging their duties. It is important for boards to seek professional advice for various matters including legal issues, accounting issues and investment advice.

When in doubt, a director should not hesitate to ask the chair or senior paid staff for the information that they need to fulfill the duties associated with their position. While not-for-profit organizations will be at various stages in their organizational development, and some may not have board manuals and well-developed policies, it often takes just one motivated director to bring these tools into existence for the benefit of future boards and the organization as a whole.

Where to find more information

CPA Canada Publications on Not-for-Profit Governance

Available at www.cpacanada.ca/nfpgovernance

About the authors

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The first edition of this publication was written by Jane Burke-Robertson, who was a leading charity and not-for-profit lawyer in Canada. Jane was consistently recognized as an expert by numerous rankings, including Lexpert and The Best Lawyers in Canada. She was a founding co-chair of the Ontario Bar Association's Charity and Not-for-Profit Law Section and a founding co-chair of the Annual CBA Charity Law Symposium. Jane was a frequent speaker and wrote extensively in this subject area. She received numerous awards for her contributions to the sector, both as a legal practitioner and a tireless volunteer. Jane sadly passed away from cancer in 2013. She is remembered with immense fondness and admiration by her many friends and colleagues in the sector.

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Nicole is a partner in Miller Thomson LLP's Social Impact Group. She practices exclusively in the area of charity and not-for-profit law. She works with many different types of organizations, including charities, non-profits, and social enterprises, with activities in Canada and internationally. Nicole advises clients on a wide range of topics and issues including corporate structure, governance, operations, charitable gifts and receipting, social finance, tax and corporate compliance, duties and liabilities of directors, fundraising campaigns, planned giving, endowments, donor advised funds, domestic and overseas activities, audits, reorganizations, mergers, political activity, public policy, lobbying, anti-spam, and privacy. She works with clients across Canada in English and French.

Before developing a full-time practice in charity and not-for-profit law, Nicole practiced corporate tax law at a Big Four accounting firm. She has completed CPA Canada's three-year In-Depth Tax Course and the Canadian Board Diversity Council's Corporate Governance Education Program.

She has written for many publications, including the Canadian Tax Journal, and spoken at numerous conferences on charity and non-profit related matters, including conferences hosted by the Canadian Tax Foundation, the Canadian Association of Gift Planners, and the Association of Fundraising Professionals. For many years, she was a contributing

editor to *Canadian Tax Focus*, the young practitioners' newsletter of the Canadian Tax Foundation. Currently, she is the co-editor of Miller Thomson LLP's free *Social Impact Newsletter*.

Nicole sits on the Executive of the Ontario Bar Association's Charity and Not-for-Profit Law Section. She is an active volunteer in the Toronto community and is the former Co-Chair of the Young Leadership Council of the Toronto Symphony Orchestra.



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